

Mid-Year Investment Outlook 2025

Stable foundations for an unstable world



Authors

Karen Ward

Chief Market Strategist EMEA

Tilmann Galler

Global Market Strategist

Maria Paola Toschi

Global Market Strategist

Hugh Gimber

Global Market Strategist

Aaron Hussein

Global Market Strategist

Max McKechnie

Global Market Strategist

Natasha May

Global Market Analyst

Zara Nokes

Global Market Analyst

In brief

- Markets are playing a crucial role in guiding the US administration towards sensible, amicable policy, but uncertainty will still likely drag on activity ahead. **The thing to fear is fear itself.**
- We take comfort from the strong fundamentals of the US private sector, and the way that other countries are reacting with their own stimulus.
- Investors must focus on stable strategies to thrive in these unstable times:
 - **Use regional stock diversification and income strategies.** Diversifying exposure will reduce risks linked to over dependence on the fortunes of tech, and the broad US market.
 - **Own bonds for bad weather, not all weather.** Fixed income investors are contending with conflicting risks of higher inflation and slowing growth. Despite this, we still see bonds playing an important role in a portfolio.
 - **Use alternative investments for alternative risks.** As the threat of resurgent inflation looms large, investors should remember the lessons from 2022 and how real assets can provide an inflation hedge.
 - **Be mindful of currency exposure.** Currency moves could compound losses in US assets in several risk-off scenarios. Be aware of FX exposures and consider hedging USD positions.

The thing to fear is fear itself

In his inaugural speech in 1933, US President Franklin D Roosevelt used the now famous phrase “the only thing we have to fear is fear itself”. He argued that it was merely fear that was crippling US demand in the aftermath of the Great Depression, rather than any structural issues buried in the foundations of the economy. This quote is relevant to the key risks facing the US, and global economy, today.

The global economy is structurally sound. For the last few years, it has defied calls for recession despite soaring inflation and interest rates, thanks to robust household and corporate balance sheets. The risk is that uncertainty about US policy causes firms and households to pause their spending plans, choosing to wait and see. The thing to fear is fear itself.

At the time of writing there is considerable uncertainty about the scale and scope of tariffs the US will enact on its trading partners. The shocking numbers announced on ‘Liberation Day’ have already retreated but the effective tariff rate on US imports still sits at its highest level since the 1940s (see **Exhibit 1**). A US trade court ruling against the president’s declaration of emergency to enact sweeping tariffs in late May has added to the uncertainty. With multiple other legal routes for the president to proceed if the reciprocal tariffs are ultimately revoked, we suspect the administration will find ways to keep pursuing their trade policy goals.

One reason for the administration to find a workaround to the current legal challenges is that it is already planning for how the revenue collected will be spent. The fiscal package making its way through both houses of Congress not only extends the tax cuts offered under the 2017 Tax Cuts and Jobs Act but adds further fiscal giveaways. This results in tax cuts and spending to the tune of \$5,3tn based on CBO estimates. Although in theory these upfront tax cuts will be met with tariff revenue and spending reductions later down the line, the bond market is understandably dubious about the path the US authorities are on (see **Exhibit 2**).

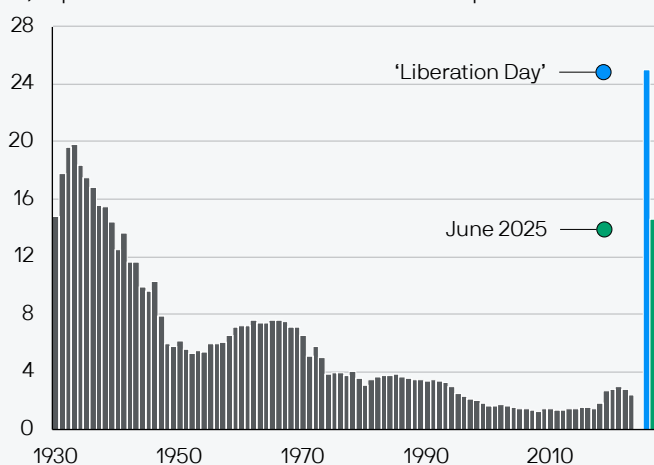
Whether the benefits to the US economy from fiscal loosening are anyway outweighed by higher interest rates is an important question. As the issuer of the world’s reserve currency, the US Treasury can get away with more than countries such as the UK (see **Be mindful of currency exposure**), but the UK’s ‘Liz Truss episode’ does contain a lesson for the US administration: when the economy is at full employment, fiscal loosening will merely be met with higher borrowing costs.

The high levels of uncertainty about the outlook for trade and fiscal policy, and consequently growth and inflation, may make for a bumpy ride for markets in the second half of 2025, as investors react to incoming growth and inflation data.

Exhibit 1: US tariffs have come down since early April but are still historically high

US effective tariff rate

%, import duties collected as a share of total import value

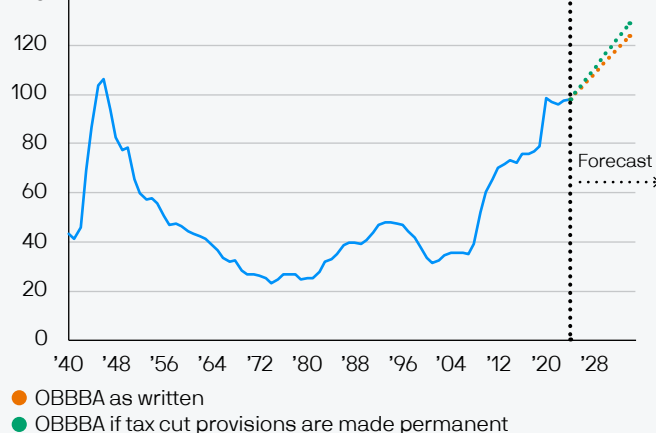


Source: Cato Institute, US Department of Commerce, J.P. Morgan Asset Management. Estimates are by J.P. Morgan Asset Management. Data as of 6 June 2025.

Exhibit 2: The One Big Beautiful Bill adds even more borrowing to an already concerning fiscal trajectory

US net federal debt

% of GDP



Source: BEA, CFRB, US Treasury, J.P. Morgan Asset Management. Forecasts are based on CFRB projections and internal J.P. Morgan Asset Management estimates and include interest costs. OBBBA refers to the One Big Beautiful Bill Act as passed by the House of Representatives on 22 May 2025. Data as of 31 May 2025.

The key data we will be tracking is as follows (all of which will, of course, be made accessible in our daily *Guide to the Markets*):

- Business capex and hiring intentions to gauge the damage of ‘wait and see behaviour’ by companies (see **Exhibit 3**).
- Consumer durable goods spending intentions to gauge the damage of ‘wait and see behaviour’ by households.
- Purchasing Managers’ Indices – specifically, the input and output price components – are key watch items for investors gauging how businesses are behaving, and the passthrough of tariffs.
- Consumer inflation expectations which may make the Federal Reserve (Fed) hesitant to cut interest rates.

We suspect the data will point to a US economy that is slowing rather than falling into recession. If anything, we see the risks being skewed towards inflation, rather than recession, concerns. Goldilocks’ recent encore was, in our view, largely thanks to a surge in US migration which helped quickly drag down wage growth and broader inflationary pressures in the US (see **Exhibit 4**). With migration now effectively halted after a very strong signal from the current administration, the risk of another 2022 supply shock that gets matched with a demand boosting fiscal shock would once again shock investors with a greater than expected pickup in inflation.

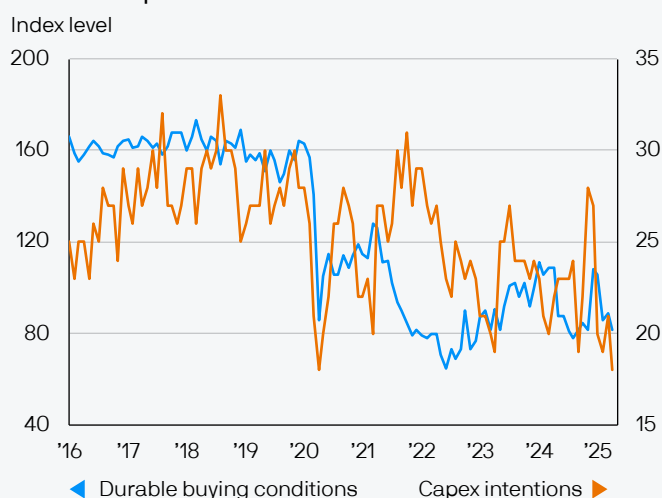
This balance of risks places the Fed in an uncomfortable position and in our view puts them in a reactive, rather than pre-emptive, mode. Investors have already scaled back their expectations for rate cuts by the Fed this year. In our view, inflation would have to rise fairly meaningfully for the Fed to openly start talking about raising rates, particularly given the president’s vocal opinions on US monetary policy. Our central expectation is that the Fed remains on hold through the remainder of 2025.

If we have misjudged the downside risks and unemployment were to start rising, we suspect the Fed would ignore inflation concerns and ease policy, perhaps significantly. In this scenario, investors should not forget the recession protection that core bonds afford (see **Own bonds for bad weather, not all weather**).

Looking beyond the US, it is once again apparent that Europe is often at its best when faced with a common adversary or crisis. We are encouraged by meaningfully more positive domestic policy. Germany is now using the considerable fiscal space it has guarded in recent years. The new government’s proposed fiscal stimulus is huge, with the key question for Germany’s growth outlook being how quickly such a large volume of money can be deployed.

Exhibit 3: Households and companies are in ‘wait and see’ mode

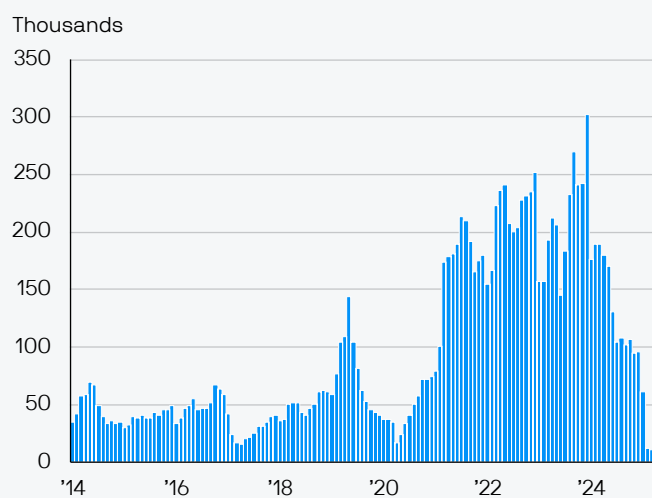
US consumer durable buying conditions and small business capex intentions



Source: LSEG Datastream, NFIB, University of Michigan, J.P. Morgan Asset Management. Data as of 31 May 2025.

Exhibit 4: Strong signals from the US administration have halted migration

US southwest land border encounters



Source: Haver Analytics, US Customs and Border Protection, J.P. Morgan Asset Management. Encounters data includes people detained for being in the US illegally, people deemed inadmissible at a port of entry and people expelled in the interest of public health. Data as of 31 May 2025.

The backdrop for the European consumer is also improving. Real wages continue to rise, labour markets broadly remain firm, and falling interest rates might finally encourage the region to deploy some of the sizeable savings that were accumulated during the Covid pandemic (see **Exhibit 5**).

Europe's domestic recovery could be derailed if tensions with the US spike higher once again. Late May provided a clear example of how quickly things can change, with the US administration threatening to introduce additional tariffs of up to 50% on the European Union (EU) as early as 1 June, before deescalating just two days later. President Trump cited the goods trade deficit that the US has with the EU, as well as slow progress on trade talks, as rationales for these potentially higher tariffs. We suspect, as with other regions, there is a deal to be done as a lengthy retaliatory trade battle doesn't appear in the interests of either side. If Europe can maintain its domestic recovery there may well be scope for European stocks to narrow their outsized valuation gap with the US (see **Use regional stock diversification and income strategies**).

The UK shares many of continental Europe's potential tailwinds, including a sizeable pot of savings built up during the pandemic. The trade backdrop is arguably also improving for the UK. A trade deal with the US has already been secured, but – more importantly for UK exporters – relations with the EU have also markedly improved.

The key challenge facing the UK in the remainder of 2025 is the Autumn Budget, where the chancellor is once again facing difficult decisions if she wishes to stick to her fiscal rules. Last autumn, Chancellor Reeves hiked one of the few taxes that was not ruled out in her party's election manifesto – employers' national insurance contributions – to fund a boost to public spending. As the 2025 Autumn Budget approaches, higher global interest rates may well leave the UK government deciding between cutting spending or raising taxes.

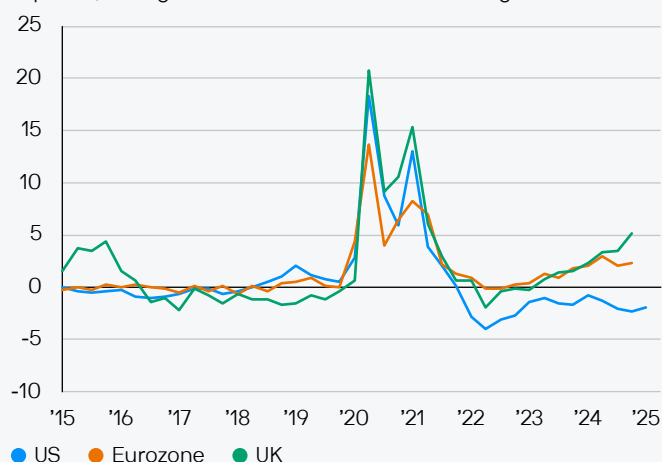
Given the public backlash against last autumn's tax hike, as well as the need to support growth, we suspect any fiscal decisions will focus on restraining medium-term spending. If, however, the Office for Budget Responsibility – the UK's fiscal watchdog – marks down its perennially optimistic productivity forecasts, the fiscal outlook is likely to look worse come autumn, potentially forcing the chancellor to reconsider increases to the 'big' taxes.

The Bank of England (BoE) may also be forced to pause its easing cycle unless UK inflation pressures dissipate quickly (see **Exhibit 6**). Core inflation remains stubbornly elevated in the UK, defying the Bank's ongoing optimism about inflation drifting back to 2% within the target horizon.

Exhibit 5: European households have a huge pool of savings to deploy

Excess savings rates

% points, savings rates relative to 2015-2019 average

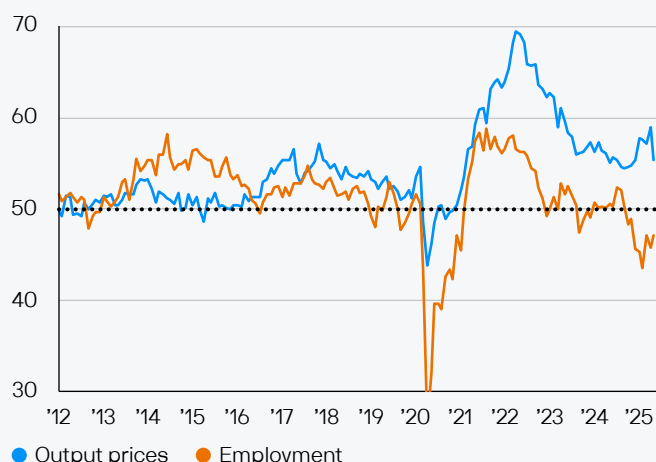


Source: BEA, Eurostat, LSEG Datastream, ONS, J.P. Morgan Asset Management. Data as of 31 May 2025.

Exhibit 6: The combination of slowing growth and persistent inflation is a headache for the BoE

UK composite Purchasing Managers' Indices (PMI)

Index level



Source: Bloomberg, S&P Global, J.P. Morgan Asset Management. A PMI score of 50 indicates that prices and employment are neither rising nor falling, above 50 indicates rising prices or employment. Data as of 31 May 2025.

Over in Asia, China appears to be continuing to largely evade problems in sending goods to the US by using intermediate trading partners (see **Exhibit 7**). Should the US clamp down on this in upcoming negotiations with other regions, then China, like Germany, must decide whether to stimulate domestic demand to compensate for weaker export demand. However, unlike Germany, China has shown little inclination towards a meaningful domestic stimulus package.

Beijing does seem to have managed to stem the decline in property prices and its efforts to encourage domestic equity investment have helped boost stock prices, making consumer wealth effects more favourable. But we are yet to see Beijing's actions translate into a meaningful rise in consumer confidence or consumer spending, which will be crucial if China is to weather external trade pressures.

However, January's DeepSeek announcement was a symbolic reminder of what China's government has done right, which many emerging economies fail to (see **Exhibit 8**). China focused on education, and thus each year churns out a large number of highly skilled graduates. If the government promotes entrepreneurship – and engineers are confident they will profit from the fruits of their labour – then China could be at the leading edge of tech innovation.

Overall, despite the noise, we expect a reasonably benign outlook with a transition over the next year to slower and more geographically dispersed growth. But there are considerable risks in both directions (see **Global market scenarios and risks**). Risks to the downside would result from fear caused by policy uncertainty leading to a more meaningful retrenchment in corporate hiring and capex plans. And perhaps even more disruptive, the risk of a more vengeful return of inflation (see **Use alternative investments for alternative risks**).

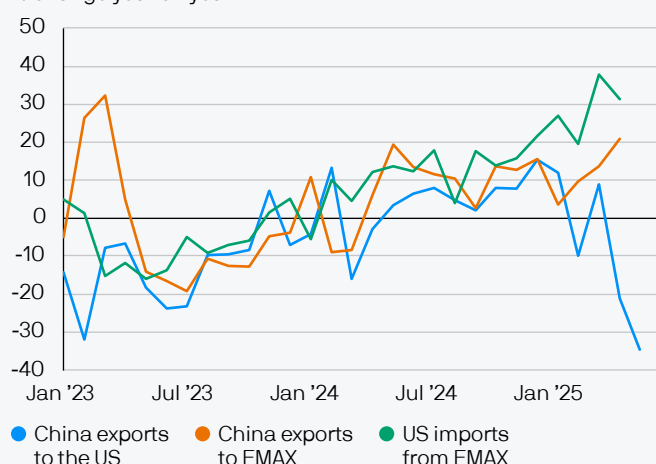
Having a stable strategy to cope with an unstable world will be critical to being able to switch off from the tedious continual political noise, safe in the knowledge that even should that noise become a destabilising cacophony, there are capital preservation strategies in place.



The risk is that uncertainty about US policy causes firms and households to pause their spending plans, instead choosing to wait and see.

Exhibit 7: China appears to be re-directing its exports through other markets

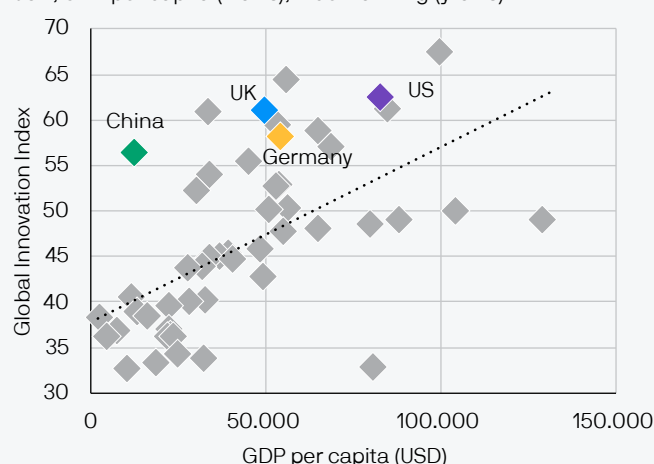
Chinese exports to and US imports from EMAX countries
% change year on year



Source: China Customs, LSEG Datastream, US Census Bureau, J.P. Morgan Asset Management. EMAX includes Brunei, India, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam. Data as of 31 May 2025.

Exhibit 8: DeepSeek was a reminder of China's innovative capacity

GDP per capita and 2024 WIPO Global Innovation Index
USD, GDP per capita (x-axis); index ranking (y-axis)



Source: World Bank, World Intellectual Property Organization (WIPO), J.P. Morgan Asset Management. Index rankings are taken from the WIPO Global Innovation Index 2024: Unlocking the Promise of Social Entrepreneurship. Data as of 31 May 2025.

Use regional stock diversification and income strategies

The first half of 2025 has been quite the ride for equity investors. Volatility could well persist as the economic narrative continues to swing from recession to inflation fears, and the markets steer politicians towards sensible, amicable policy choices. Not getting top and tailed on newsflow, and being more regionally diversified than was optimal last cycle is the right strategy for ending the year on a high.

Following the strongest quarter since 2015 for European stocks relative to the US market,¹ global equities slumped at the start of April on the back of US tariff announcements. This negativity proved short lived, however, with the S&P 500 index only requiring 18 trading days to recover its early April losses. Provided that investors started the year with a well-diversified portfolio across regions and styles, doing nothing has likely been the optimal strategy.

Stepping back, three key market expectations have been put to the test thus far in 2025. The first was that technology company earnings would remain extremely strong, even with some moderation anticipated in consensus forecasts. Second was the assumption that earnings growth was set to broaden out beyond the megacap tech firms, to other sectors in the US market. The third assumption was that this broadening of earnings growth across sectors would support less tech-heavy regional equity markets.

Prior to April's tariff announcements, these market narratives had already developed as new information came to light. Most importantly, 'DeepSeek Monday' in January had called into question the leadership of US tech giants in the AI race. The Chinese start-up DeepSeek claimed that it had managed to develop a large language model that would rival US equivalents with a fraction of the time and cost, which sparked a rotation away from the megacap US tech firms. And in addition to less exposure to the technology sector, which looked increasingly beneficial, Europe's fiscal pivot added to the optimism towards the region.



Most importantly, we still believe that unlike the last 10 to 15 years, investors will see better risk-adjusted returns from being well regionally diversified than from running concentrated US portfolios.

US trade policy has tested market expectations further. After significant regional divergence in the first quarter of 2025, global equity markets have tracked each other more closely since 2 April, falling on trade escalation and rising when tensions have eased. The sector moves witnessed in April highlight where investors have looked for safety, with defensive industries such as staples and utilities outperforming more cyclical sectors such as energy and consumer discretionary over the month.

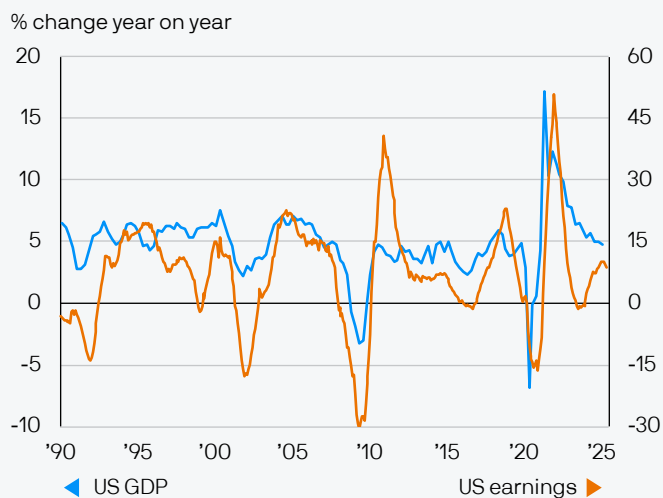
Importantly, corporate health remains a key support to the equity market. The slower economic growth that we anticipate ahead is not due to businesses having levered up too far and now needing to pull back. Instead, it reflects corporates battenning down the hatches given elevated uncertainty, but from a position of relative balance sheet strength. This implies that earnings growth is likely to stall rather than slump, with a sharper decline likely requiring a more hostile policy stance to be sustained by the US administration.

The challenge for equity investors is that consensus earnings expectations are still more optimistic than the macro outlook implies, despite some moderation year to date. US earnings forecasts for 2025 have fallen by five percentage points since the start of January, but still sit at 9% year on year, with a further 14% growth anticipated in 2026. In Europe, 2025 earnings growth expectations began the year at a more moderate 8% year on year and have since come down significantly (see **Exhibits 9 and 10**).

¹ S&P 500 and MSCI Europe in local currency.

Exhibit 9: S&P 500 earnings will slow with the economy

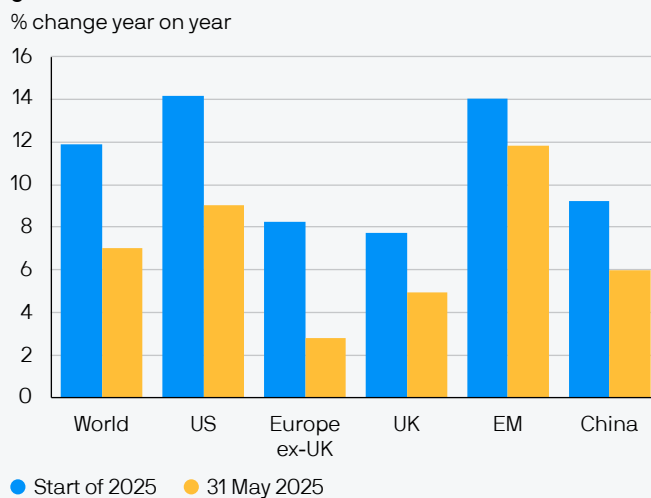
US nominal GDP growth and S&P 500 earnings growth



Source: BEA, IBES, LSEG Datastream, S&P Global, J.P. Morgan Asset Management. US earnings are S&P 500 12-month trailing earnings per share, as published by IBES. Data as of 31 May 2025.

Exhibit 10: Consensus earnings expectations still look too optimistic

Consensus estimates for global 2025 earnings per share growth



Source: FTSE, IBES, LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. MSCI indices are used for World, Europe ex-UK, EM and China. UK is FTSE All-Share and US is S&P 500. Data as of 31 May 2025.

The ability of corporates to pass higher input costs through to consumers is critical, but frustratingly difficult to forecast. In 2019, US margins did soften by approximately half a percentage point, although the magnitude of the trade shock was far smaller than today. This time, even if corporates do succeed in maintaining their pricing power, we anticipate that higher consumer prices would still result in weaker demand over time, which in turn would weigh on corporates' earnings even if margins remain at robust levels. First quarter earnings season offered little insight into how corporates would handle higher input costs, with many companies either providing multiple sets of guidance based on different scenarios or preferring to pull their guidance altogether.

Uncertainty about future tax policy may have been another factor making corporates reluctant to offer firm guidance. When President Trump passed the Tax Cuts and Jobs Act in December 2017, a lower corporate tax rate triggered a 10-percentage point upgrade to earnings expectations in just three months. Yet while the exact shape of this year's tax bill is still being refined, the 2025 tax cuts are set to be much more focused on consumers than corporates, which are therefore less likely to have a broad-based impact. Equity investors will also need to weigh the impact of new fiscal impetus against the impact on multiples of higher bond yields.

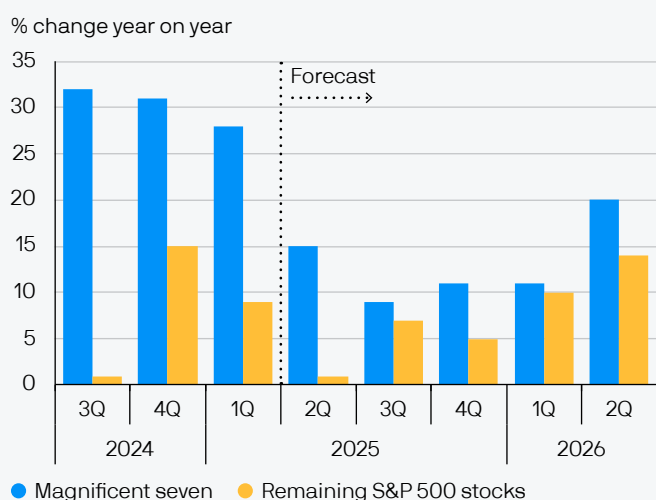
The earnings delivery of megacap tech is another vital part of the overall profits outlook (see **Exhibit 11**). One way to rationalise still lofty US earnings expectations despite building macro headwinds is to argue that the megacaps will be immune to cyclical weakness. It could yet be the case that CEOs see new artificial intelligence capabilities as so critical that tech capex remains rock solid, despite weaker growth. However, this feels a bold assumption to rely upon in such an uncertain macro environment, and one with no historical precedent (see **Exhibit 12**). Trade restrictions that limit the transfer of critical technologies around the world are another factor to consider when assessing the tech earnings outlook, beyond just the level of tariffs applied.

Valuations are a poor guide to future returns on any short-term horizon, but if earnings expectations are set to decline, we note that valuations across many markets remain elevated today. This suggests valuations have little room to absorb any earnings disappointment. In the US, this year's derating has largely been a megacap story, with the valuation of the largest 10 stocks in the S&P 500 having fallen from 30x forward earnings entering the year to 27x at the end of May. In contrast, the valuation of the remaining 490 stocks is essentially unchanged, sitting at 20x forward earnings (see **Exhibit 13**).

Valuations outside of the US are certainly more reasonable when compared to the S&P 500 – but compared to their own history, they too now suggest a relatively high degree of optimism is baked in (see **Exhibit 14**). In Europe, equity valuations sit slightly above their long-run average levels, at 16x forward earnings, and are higher than at the start of 2025. Chinese valuations have also picked up relative to the start of the year, despite a still-sluggish growth outlook.

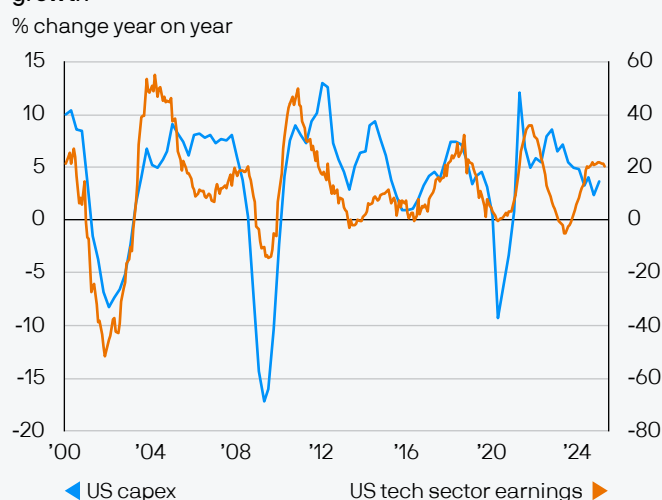
Given this highly uncertain backdrop, what should investors do? Most importantly, we still believe that unlike the last 10 to 15 years, investors will see better risk-adjusted returns from being well regionally diversified than from running concentrated US portfolios (as we laid out in our 2025 Outlook). The rotation from the US equity market to other developed markets has played out more quickly than we expected, but we still see room for this rotation to continue. This implies investors can benefit from rebalancing global equity portfolios that are still running significant US equity overweights.

Exhibit 11: US megacaps are still expected to see stronger earnings than the rest of the US market
S&P 500 earnings growth



Source: FactSet, S&P Global, J.P. Morgan Asset Management. Earnings growth forecasts are derived from FactSet consensus data. Data as of 31 May 2025.

Exhibit 12: The risk to tech is a material cut in corporate capex
US non-residential capex and US tech sector earnings growth



Source: BEA, LSEG Datastream, MSCI, J.P. Morgan Asset Management. Capex is non-residential private fixed investment, and tech sector earnings are MSCI USA Technology 12-month trailing earnings per share. Data as of 31 May 2025.

Exhibit 13: The US derating has primarily been a megacap story

Forward P/E ratio of the S&P 500 top 10 vs. the rest
x, multiple

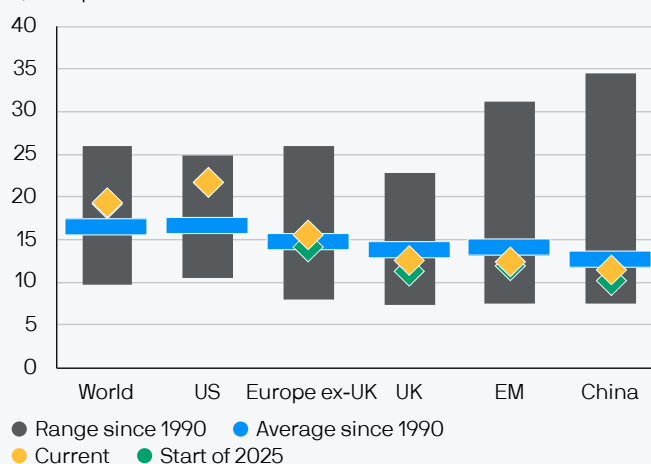


Source: FactSet, S&P Global, J.P. Morgan Asset Management. The top 10 stocks are based on the 10 largest index constituents at the start of each month. Data as of 31 May 2025.

Exhibit 14: Outside of the US, valuations have risen year to date

Global forward P/E ratios

x, multiple



Source: FTSE, IBES, LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. MSCI indices are used for World, Europe ex-UK, EM and China. UK is FTSE All-Share and US is S&P 500. Earnings data is based on 12-month forward estimates. Data as of 31 May 2025.



Valuations are a poor guide to future returns on any short-term horizon, but if earnings expectations are set to decline, we note that valuations across many markets remain elevated today.

At a regional level, our conviction in European markets, including the UK, remains stronger than our conviction in Japan. This reflects our view that a stronger yen is likely in multiple macro scenarios, which would weigh on repatriated overseas earnings and therefore pose headwinds for the relatively internationally oriented Japanese stock market. Simultaneously, many investors appear reluctant to embrace the positive growth impact that we expect from Europe's fiscal pivot, as evidenced by the still large valuation discount on offer in many European sectors relative to their US counterparts (see [Exhibit 15](#)).

The outlook for emerging markets (EM) relative to developed markets appears less clear. As we lay out in [Be mindful of currency exposure](#), a weaker US dollar should provide a tailwind to EM over the medium term, but a sluggish macro outlook in China tempers our

optimism. Arguably the strongest rationale for EM allocations lies in the need to diversify global tech exposure, with further 'DeepSeek Mondays' impossible to rule out as tech innovation across Asia continues at a breakneck pace.

Income-oriented strategies are also likely to prove relatively defensive. In an earnings contraction, dividend growth typically pulls back by roughly half that of earnings, helping to buffer total returns from stock price drawdowns (see [Exhibit 16](#)). With payout ratios at low levels and corporates pulling back from capex, investors might expect even greater dividend resilience in a slowdown scenario today than has been typical historically.

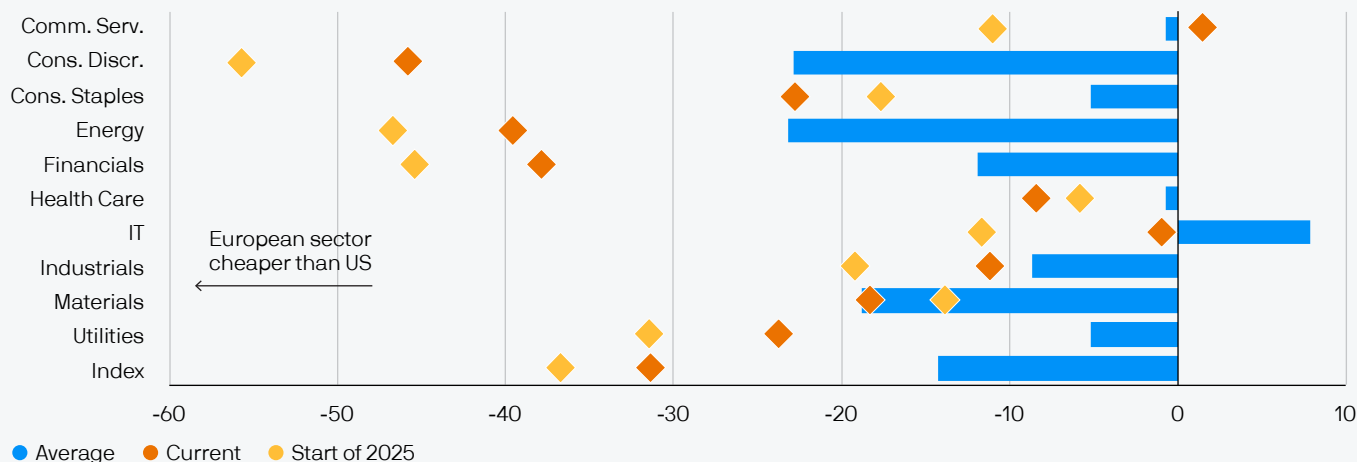
Overall, the rollercoaster ride witnessed in global equity markets in the first five months of the year appears unlikely to reach a halt in the near term, not least because markets will continue to play a critical role guiding politicians towards more sensible, amicable outcomes. Robust corporate health provides something of a guardrail against large downside risks, but earnings expectations likely still need to moderate further given a slowing economic backdrop.

The top priority for investors must therefore be to ensure that their portfolios are sufficiently regionally diversified, with income-focused strategies acting as another tool to guard against further market 'wobbles'.

Exhibit 15: Many European sectors still trade at an abnormally large discount to US counterparts

MSCI Europe relative valuation vs. the US

%, relative discount/premium based on 12-month forward P/E ratios



Source: LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. The chart shows the current percentage discount of the index or sector 12-month forward P/E ratio vs. the equivalent for the S&P 500, and the average since 1995. Communication Services average is calculated using data from 1995 to 2000 inclusive and from 2005 to date, due to sector composition changes. Data as of 31 May 2025.

Exhibit 16: Dividends tend to hold up much better than earnings

MSCI World earnings and dividend drawdowns

%, drawdown from rolling two-year high



Source: IBES, LSEG Datastream, MSCI, J.P. Morgan Asset Management. Earnings and dividends are both 12-month trailing per share. Periods of recession are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Own bonds for bad weather, not for all weather

Government bond markets have been caught between oscillating narratives for several quarters. When recession fears have come to the fore, bond yields have fallen as investors priced in more aggressive central bank easing. Yet when the market's focus turned from downside growth risks to upside inflation risks – perhaps thanks to fiscal largesse – the direction of bond yields has reversed. The net result from these push and pull factors has been for government bond yields to fluctuate in a range of 3.5%-5% for the last two years in the US and the UK, and between 2%-3% at a eurozone level (see **Exhibit 17**). This is a more volatile experience than perhaps we would expect from our prime 'risk-free' assets.

Looking forward, we expect some of this volatility to persist but we still think core bonds deserve their place in providing income and downside protection.

As we go to print, bond yields are nudging towards the upper end of this 3.5%-5% range as the markets focus on the fiscal package making its way through Congress and a somewhat concerning outlook for the trajectory of US government debt. Whether clients should buy bonds in a world in which governments don't seem to care about debt is a key question frequently hitting our inbox.

It's an understandable question. In its current form, the headline impact of the US fiscal bill is forecast to add around \$2.4tn to the already sizeable \$21tn expected to be borrowed in the next 10 years. To prevent a larger price tag, the bill includes back-loaded spending cuts, and classifies many of the tax cuts as temporary. The experience of the 2017 Tax Cuts and Jobs Act raises doubts about whether these temporary tax cuts really will be allowed to expire later down the line, while there are also questions about whether spending cuts to areas like Medicaid pencilled in for future years are politically feasible.

However, we think it would be challenging for US 10-year Treasury yields to move sustainably through 5% without inflicting significant macro disruption. With US mortgage rates already close to their highest levels since 2002, we would expect significantly higher yields to lead to tighter financial conditions which would in turn slow the economy over time (see **Exhibit 18**). Higher yields could also spark a sharp fall in equity prices, and given the close link between the level of the S&P 500 and consumer confidence, economic growth could therefore take another hit from weaker consumer spending.

Exhibit 17: Western government bond yields have been rangebound for two years

Nominal 10-year government bond yields



Source: LSEG Datastream, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Exhibit 18: The passthrough to mortgage rates and the impact on the economy should cap bond yields

US 30-year fixed mortgage rate



Source: LSEG Datastream, Mortgage Bankers Association of America, J.P. Morgan Asset Management. Data as of 31 May 2025.

While it might feel uncomfortable, we would therefore suggest leaning more into duration when 10-year US Treasury yields move closer to 5%.

Throughout this volatility, we shouldn't lose sight of the downside protection that bonds will afford us if the attention shifts once again towards recession risk. Weakening labour markets would be the most likely catalyst for significantly lower yields. Sticky wage growth in many developed markets has been an important driver behind persistent services inflation in the post-pandemic era. For central bankers to gain greater confidence that upside inflation risks are being overwhelmed by weaker demand, a material rise in unemployment is likely required.

If this downside scenario for growth does materialise, it's important to recognise that there is scope for the Federal Reserve (and others) to cut more aggressively than the market is pricing. Even if longer-dated bond yields fall by less than we have seen in previous cutting cycles, they would likely still outperform shorter-dated equivalents on a total return basis in this scenario. Bonds' ability to diversify against a growth shock is therefore fully intact, and remains one of their most appealing characteristics in a multi-asset context (see **Exhibit 19**).

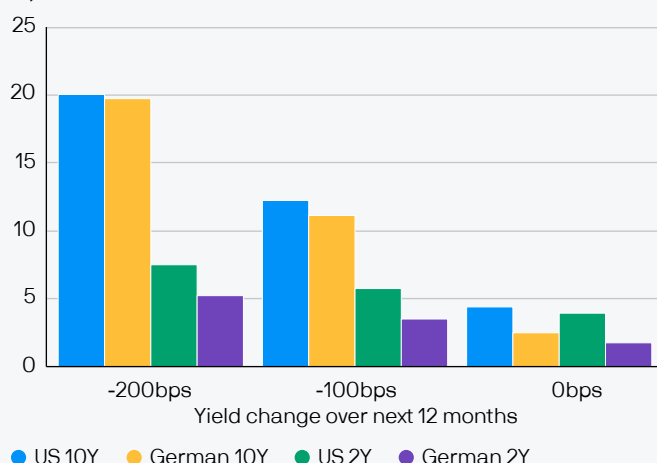
While we see reasons to find duration attractive when the US 10-year approaches 5%, we believe there should be a lower limit on yields below which bonds lose their attractiveness. More volatile inflation in a world of deglobalisation, more active fiscal policy, and changes to bond market structure are all reasons why in our view, the term premium – the additional compensation investors require for the risk of holding longer-term bonds – should be much higher than it was over the last decade (see **Exhibit 20**). There are also questions around the appetite for government bonds as safe haven assets given the correlation between stocks and bonds is no longer reliably negative.

While government bonds in other regions of the world are unlikely to fully decouple from US Treasuries, we would argue there are bond markets outside of the US where volatility in the coming year should be more contained. Gilts are arguably best positioned, given a relatively weak growth backdrop and a UK government that is much more constrained by its own fiscal rules. We are much more wary of the outlook for Japanese bonds, where a sustained improvement in wage growth has pushed inflation above target and there is still very little monetary policy tightening priced in by markets.

Exhibit 19: Government bonds still offer diversification benefits against a growth shock

Government bond return scenarios

%, total return over 12 months

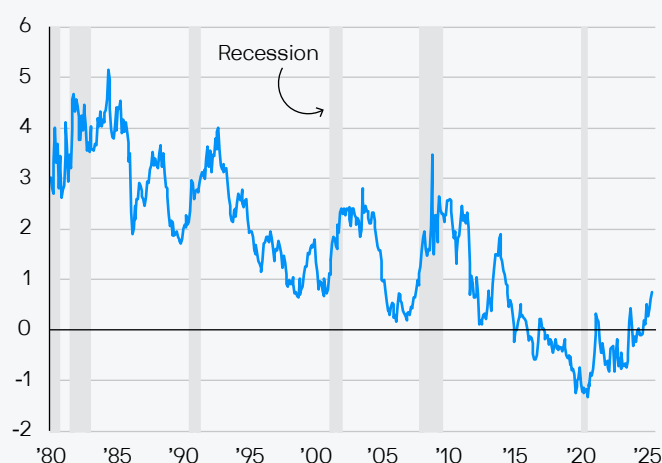


Source: LSEG Datastream, J.P. Morgan Asset Management. The chart indicates the calculated total return achieved by purchasing the given government bond at its current yield and selling in 12 months' time given various changes in yield. For illustrative purposes only. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Exhibit 20: The term premium has risen towards more normal levels

US 10-year Treasury term premium

%



Source: Federal Reserve Bank of New York, LSEG Datastream, J.P. Morgan Asset Management. Term premium is the extra compensation demanded by investors for holding longer-duration Treasuries over a rolling series of shorter-term Treasuries. Chart shows the Federal Reserve Bank of New York's ACM term premium. Periods of recession are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Eurozone sovereigns sit in the middle of this spectrum, with inflation much less of a headache for the European Central Bank but bond supply likely to accelerate to meet new fiscal spending. For European investors, the decision between US Treasuries and euro sovereigns is more likely influenced by the currency hedging considerations we explained in our chapter on the US dollar.

Assuming yields remain rangebound, income is likely to act as the key source of fixed income returns. This makes the additional yield on offer from high grade credit look attractive, with defaults and spreads likely to remain contained provided that corporate earnings continue to hold up (see **Exhibit 21**). After adjusting for changes in index quality, spreads are equally tight in both high yield and investment grade credit across the US and Europe. Given tight valuations and the balance of macro risks, we prefer to focus on high quality credit.

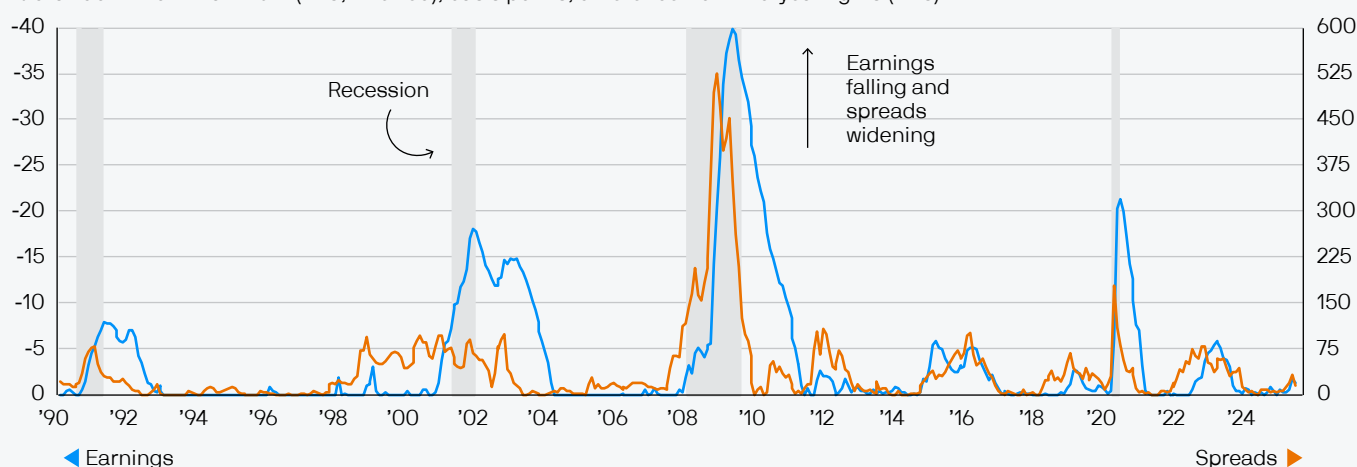


Throughout this volatility, we shouldn't lose sight of the downside protection that bonds will afford us if the attention shifts once again towards recession risk.

Exhibit 21: High grade credit spreads should be supported provided that earnings hold up

US corporate earnings and investment grade spreads

% drawdown from maximum (LHS, inverted); basis points, difference from two-year tights (RHS)



Source: Bloomberg, IBES, LSEG Datastream, S&P Global, J.P. Morgan Asset Management. Earnings are S&P 500 12-month forward earnings, spreads are Bloomberg US Aggregate - Corporate option adjusted spreads. Periods of recession are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Use alternative investments for alternative risks

Conflicting macroeconomic signals around slowing growth and persistent inflation have fuelled market volatility in 2025. Shifting tariff and fiscal policy developments have added to this uncertainty. As a result, the traditional relationship between equities and bonds has become less reliable, reinforcing the need for alternative sources of portfolio diversification.

One risk that warrants close attention is a renewed inflation surge. Rising tariffs and trade barriers represent a classic negative supply shock. At the same time, fiscal policy is taking a more expansionary turn. The Republicans' budget bill frontloads stimulus, with near-term tax cuts offset by spending cuts that are largely pushed further out beyond the end of President Trump's second term. The potential interaction between supply constraints and renewed fiscal stimulus bears uncomfortable similarities to the post-pandemic surge in inflation.

This raises an important question: what did we learn from the 2022 inflation shock, and how should investors protect against this tail risk?

The first lesson, which was particularly uncomfortable for investors, was that neither stocks nor bonds like inflation and so inflation shocks undermine traditional diversification. Investors were left with few effective hedges across liquid traditional asset classes in 2022 (see **Exhibit 22**).



Many of the best places to hide during 2022's inflation shock were in core real assets, such as infrastructure, transportation, and timberland.

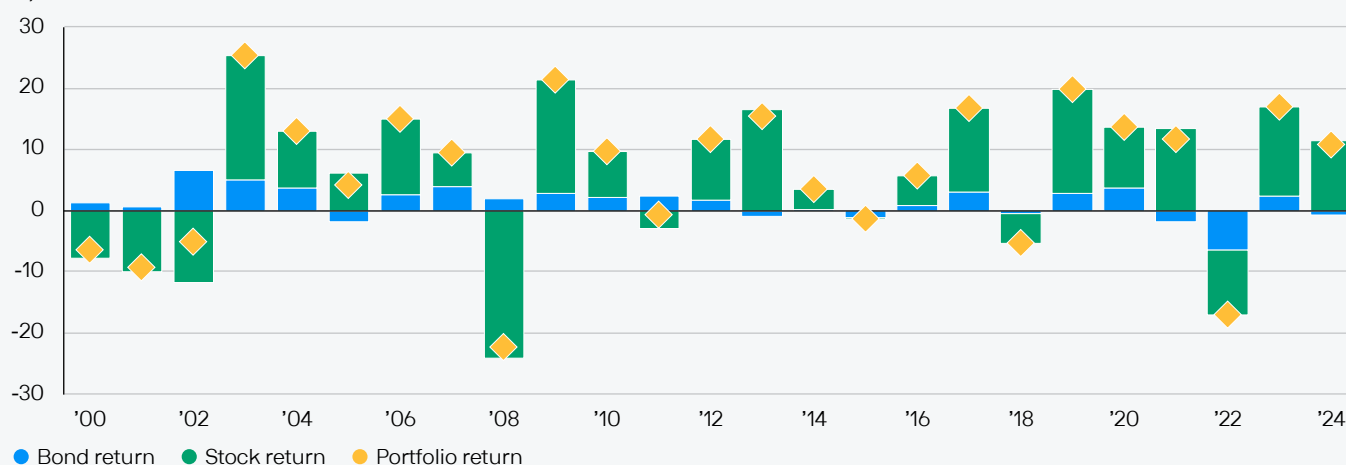
Our second lesson was that many of the best places to hide in the event of inflation were in core real assets, such as infrastructure, transportation, and timberland (see **Exhibit 23**). Core real assets are defined by their ability to generate stable, income-oriented returns backed by long-term contracts, regulatory frameworks, and/or essential service provision. Their limited sensitivity to economic cycles and explicit or implicit inflation linkage makes them particularly resilient in inflationary periods.

In core infrastructure, for example, regulated utilities and contracted renewables benefit from inflation-linked revenues, cost passthrough mechanisms, and often a regulated return on equity that increases with inflation. In contrast, merchant power plants or greenfield developments – common in more opportunistic strategies – lack contracted revenues and carry construction or market risk, making their inflation protection less reliable.

Exhibit 22: The inflation shock of 2022 saw sharp declines in both stock and bond prices

Annual returns of a 60:40 stock-bond portfolio

%, total return in USD

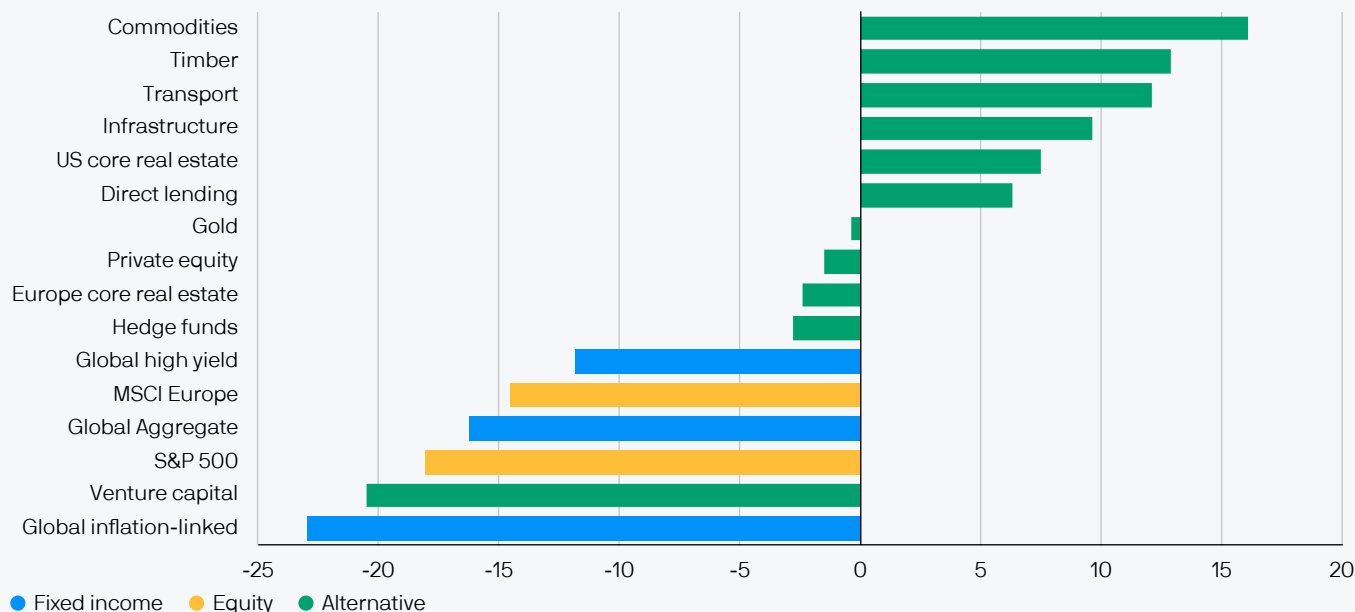


Source: Bloomberg, LSEG Datastream, MSCI, J.P. Morgan Asset Management. Stock returns are calculated using MSCI World Index and bond returns using Bloomberg Global Aggregate Index. All returns shown are in USD. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Exhibit 23: Alternatives weathered 2022's volatility far better than stocks or bonds

Selected public and private market returns in 2022

%, total return in USD



Source: Bloomberg, Burgiss, Cliffwater, FactSet, HRFI, ICE BofA, LSEG Datastream, MSCI, NCREIF, S&P Global, J.P. Morgan Asset Management. Global Aggregate: Bloomberg Global Aggregate; Global inflation-linked: Bloomberg Global Inflation-Linked; Global HY: ICE BofA Global High Yield; Hedge funds: HRFI Fund Weighted Composite; US core real estate: NCREIF Property Index – Open End Diversified Core Equity; Europe core real estate: MSCI Global Property Fund Index – Continental Europe; Direct lending: Cliffwater Direct Lending Index; Infrastructure: MSCI Global Quarterly Infrastructure Asset Index (equal-weighted blend); Timber: NCREIF Timberland Total Return Index. Private equity and venture capital are time-weighted returns from Burgiss. Transport returns are derived from a J.P. Morgan Asset Management index. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

In transportation, core strategies typically involve ships or aircraft leased under long-term time charters to investment grade counterparties, generating predictable, often inflation-adjusted cash flows. These arrangements shift operational and market risk to the lessee, reducing investors' exposure to the volatility of spot markets. By contrast, non-core strategies may involve vessels operating on short-term or spot leases, where revenues fluctuate with shipping rates that are highly sensitive to trade cycles.

Timberland can also offer strong inflation protection, as timber and land prices have historically risen with inflation. Managers can defer harvesting during weaker markets and sell when prices are more favourable. Meanwhile, as trees continue to grow, the volume of harvestable timber increases, providing a naturally compounding source of return.

For investors who cannot access core real assets, gold can serve as a partial substitute. While gold underwhelmed in 2021–2022 despite high inflation, its more recent rally underscores its value as a hedge against geopolitical uncertainty and questions around the long-term status of the US dollar. Unlike income-producing real assets, gold offers no yield, but it often acts as a store of value in periods of systemic stress. We therefore view gold as complimentary to other core real assets within a diversified portfolio, offering a different, more liquid form of protection that is particularly relevant when confidence in fiat currencies or global institutions wavers. We must also, however, recognise that after a 40% rally over the past 12 months, it appears that a lot of these concerns are already well reflected in the gold price.

Investors should also consider leaning into strategies that can capitalise on these conditions. Liquid alternatives – particularly macro hedge fund strategies – are designed to perform independently of market direction, and tend to benefit from dislocations, interest rate divergence, or increased policy unpredictability. Historically, these strategies have tended to deliver stronger relative performance in similar conditions. While not a substitute for structural inflation hedges, liquid alternatives can help reduce overall portfolio volatility, limit drawdowns, and enhance diversification at a time when traditional asset class correlations are more unstable.

These lessons remain relevant in the current environment, and we therefore believe that portfolios should be constructed with two-sided risks in mind. Core bonds remain essential for hedging recession risk, while core real assets offer long-term protection against inflation and serve as tangible stores of value in an environment of elevated macroeconomic volatility and growing concerns around fiat currency stability.

At the same time, liquid alternatives – particularly hedge fund strategies with low correlation to traditional assets – can provide an additional layer of diversification, helping to capitalise on volatility, limit drawdowns, and act as ballast during periods of market stress. Together, these alternative tools can help build more resilient portfolios in a world where inflation and growth risks are more evenly balanced than in the decade prior.



Inflation and policy uncertainty tend to generate sustained periods of market volatility and cross-asset dispersion. In the current environment, investors should consider leaning into strategies that can capitalise on these conditions.

Be mindful of currency exposure

For European investors, US dollar strength has been a near constant tailwind to US asset performance since 2010. On top of the strong performance of the assets themselves, US dollar appreciation has added an additional 2,4% per annum for euro investors, and 1,9% per annum for sterling investors, to the returns from US stocks and bonds.

However, this year has been different. The aggressive trade and fiscal policies of the new US administration have weakened the dollar and, as we highlighted in our recent piece [A new path for the US dollar](#), that weakness might have further to go.

To hedge or not to hedge?

Due to the outperformance of US assets, dollar exposure has increased significantly in many portfolios. The USD proportion in a classic 60:40 portfolio comprised of the MSCI ACWI and the Bloomberg Global Aggregate Bond Index increased from 41% at the start of 2011 to 55% at the end of May 2025, according to data from Bloomberg and MSCI.



If US policies turn out to be inflationary and destabilising, the dollar is likely to lose its positive diversification effects in the future.

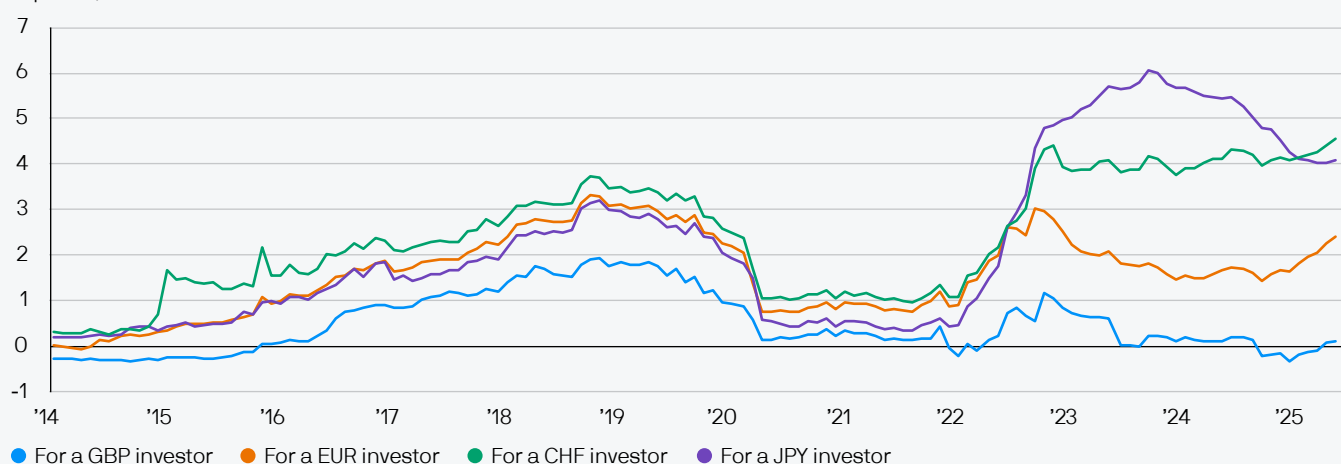
From a portfolio management perspective, investors need to pay more attention to currency exposure across asset classes. Despite this year's depreciation, the US dollar is still fundamentally a very expensive currency. Based on our 2025 Long-Term Capital Market Assumptions (LTCMA), we estimate that the US dollar is still 13% above fair value versus EUR, and 10% versus GBP. The key question for investors is how orderly a dollar decline could be.

In our base case of a US economy that slows but avoids recession, the dollar would likely depreciate in an orderly fashion in the coming years against most of its peer currencies. Hedging strategies may look unappealing in this scenario given relatively high hedging costs (see [Exhibit 24](#)). Small and orderly declines in the dollar might not warrant paying for such insurance.

Exhibit 24: USD hedging costs have become increasingly expensive

Cost of hedging a US dollar investment

% points, annualised cost



Source: Bloomberg, CME, ICE, J.P. Morgan Asset Management. Hedging costs are based on three-month forward yields across different currencies. Data as of 31 May 2025.

However, there are disorderly dollar scenarios that would make this insurance a price worth paying. Chief among these risks are a re-escalation of the tariff war, fiscal largesse and policies that challenge Federal Reserve independence or coerce foreign investors into buying super long-term bonds at a yield discount (a so-called Mar-a-Lago Accord that is being discussed in some circles).

Carry trade stutters as hedging costs rise

On the fixed income side, the USD carry trade has lost appeal. As interest rates have risen in many geographies, there is no longer a yield pickup in US Treasuries on a currency-hedged basis (see **Exhibit 25**). Therefore, international investors can only take advantage of relatively high US nominal yields if they are willing to take currency risks. The deteriorating fundamentals of the US dollar make this option now increasingly unattractive.

Interest rate normalisation in Japan is an important component of the story and European investors should be particularly mindful of the risks of getting caught in the midst of capital flows between the US and Japan. Japanese investors hold more than \$1,1tn in Treasury securities and are currently the largest foreign holder of US Treasuries. As Japanese headline inflation remains stubbornly above 3%, the Bank of Japan is expected to tighten policy going forward and longer-term JGB yields have reached all-time highs.

Japanese investors who desperately looked for income in the decades of deflation and low yields now have less incentive to move abroad to generate income. The global carry trade fuelled by cheap yen financing is stuttering. From a European perspective, as dollar headwinds intensify, a higher allocation to domestic bonds seems to be justified from a risk/return perspective.

A possible headwind for total equity returns

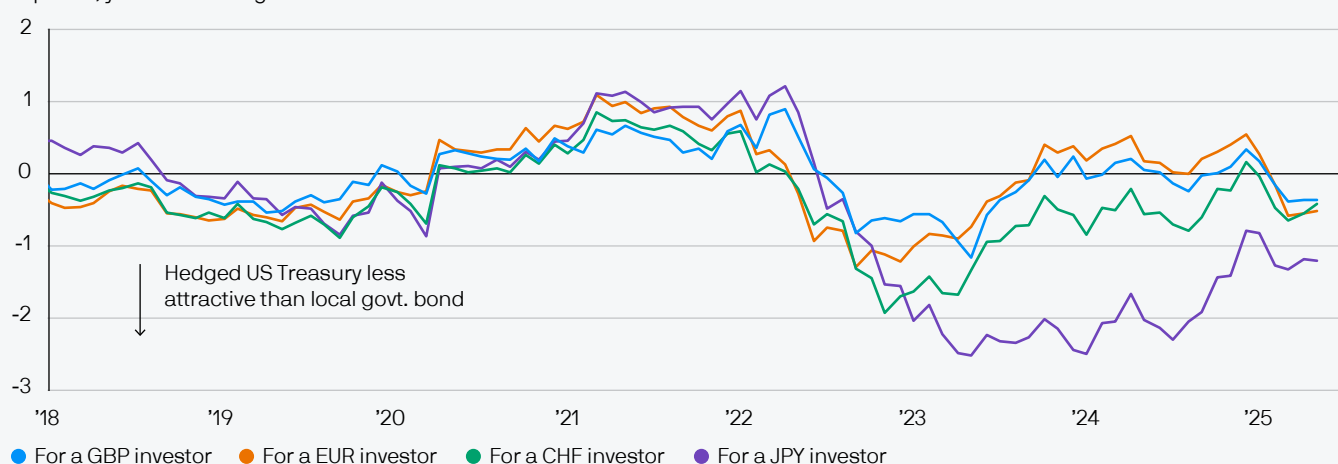
Since the end of Bretton Woods, a strong US dollar was usually accompanied by the outperformance of US equities relative to the rest of the world (see **Exhibit 26**). In periods of dollar weakness, the contrary was true. This is intuitive since the attractiveness of equity returns attracts global capital and drives movements in the dollar.

As highlighted in our **equity chapter**, the prospects for US earnings growth remain attractive but highly dependent on both economic resilience during a period of heightened uncertainty and future tech performance. On the other hand, the shift to more active fiscal policy in Europe bears the promise of better growth and returns in the coming years, which could divert some portfolio flows back across the Atlantic.

Exhibit 25: Hedged US Treasuries offer little to negative yield pickup

Yield pickup of hedged US 10-year government bond

% points, yield over local government bond

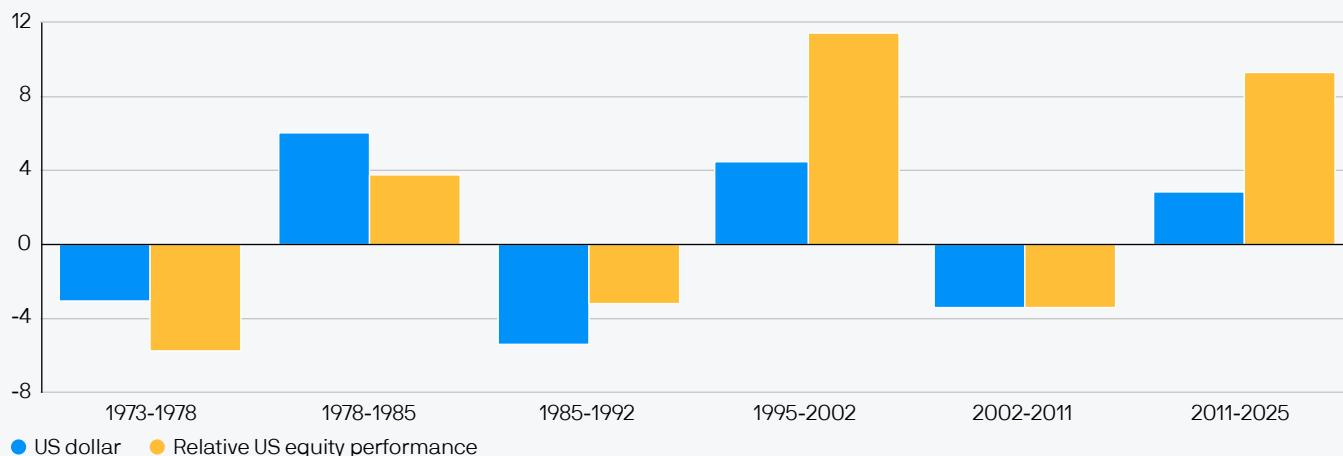


Source: Bloomberg, J.P. Morgan Asset Management. Chart shows difference between hedged 10-year US government bond yield, and local 10-year government bond yield. EUR yield is Germany. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Exhibit 26: US equity underperformance tends to be accompanied by dollar weakness

US dollar bull/bear cycles and relative US equity performance

%, annualised change over period



Source: J.P. Morgan Securities Research, LSEG Datastream, MSCI, J.P. Morgan Asset Management. US dollar cycles are based on broad real effective exchange rate. Relative US equity performance is percentage change of MSCI USA relative to MSCI World ex-US. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2025.

Investors should therefore be mindful of unhedged exposures and how currency moves have the potential to compound any relative underperformance should the US stock market falter. The first five months of 2025 are a reminder that, in the short term, these swings can be significant. In local currency terms, the S&P 500 was up 1% to the end of May, while for unhedged investors in EUR and GBP the index was down 8% and 6% respectively.

Our 2025 LTCMAs estimate a fair value for USD to EUR (GBP) of 1,29 (1,48) by 2037. This implies a 1,1% (0,8%) depreciation for the USD per year. Given the expectation of converging short-term yields between currency pairs in the coming years, strategic hedging looks increasingly attractive in a long-term context. In the short term, current hedging cost are a significant handicap to overcome, but adding dollar-hedged equity strategies can provide some protection against policy mistakes and disorderly depreciation.

The safe haven dollar premium may not be what it was

Over the last decade, investors may have been willing to have a larger dollar exposure for the additional protection it afforded them in times of market volatility. Since the height of the global financial crisis, the rolling two-year correlation of the greenback to the performance of the S&P 500 has been almost continuously negative. This meant that US dollar exposure could offset some equity risk. This was particularly evident for crises that occurred outside the US, such as the euro sovereign debt crisis and the outbreak of the Ukraine War.

However, that safe haven status no longer seems as solid. The US dollar's correlation with the stock market has been growing sharply for six months. If US policies turn out to be inflationary and destabilising, the dollar is likely to lose its positive diversification effects.

Being mindful of the right balance of currency risk in the portfolio is crucial for future investment success. The addition of currency-hedged strategies and a currency overlay, as well as broad international diversification may mitigate the risks of both more orderly and disorderly dollar declines.

Global market scenarios and risks

Our macro base case over the next 12 to 18 months sees the global economy slowing as US tariffs and policy uncertainty weigh on activity domestically and abroad.

There is, however, a high degree of uncertainty about the impact of US policy and how other countries will respond. Well-diversified portfolios are therefore essential to protect against both the risk that inflation resurges and pushes bond yields much higher, as well as the risk that the economy falls into recession.

Base case: The global economy slows

Macro: US tariffs and policy uncertainty weigh on the global economy. A slowdown is more pronounced in the US than other regions. In Europe, considerable fiscal support and lower rates support domestic demand, countering external headwinds. In China, growth remains sluggish as tensions remain elevated with the US and access to other export markets is restricted.

Markets: Regional equity diversification and income strategies are essential. European equities outperform US equities. Core bonds trade within recent ranges, with UK Gilts outperforming. The US dollar declines in an orderly fashion against a broad basket of currencies.

Downside risk: Inflation resurges

Macro: Tariff policy causes a meaningful re-acceleration in US inflation as elevated household inflation expectations lead to an entrenchment of price pressures. Tax cuts and immigration curbs worsen the inflation problem. Despite growth weakness, sticky inflation prevents central banks from easing policy.

Markets: A negative environment for stocks, with interest-rate sensitive sectors hit hardest. Rising yields on core fixed income lead to losses as stock-bond correlations remain positive. Real assets and selected commodities act as a crucial inflation hedge.

Downside risk: Deep recession

Macro: The US economy rolls over as businesses – feeling pessimistic about the outlook – switch from not hiring workers to actively firing them, triggering a vicious economic cycle. US weakness acts as a drag on activity in other regions, with fiscal and monetary support unable to offset external headwinds. Elevated geopolitical tensions exacerbate growth weakness.

Markets: The negative stock-bond correlation returns. Equities are hit by substantial earnings downgrades, but this environment is very positive for high quality fixed income, with significant capital upside as central banks cut rates by much more than markets were pricing.

Upside risk: Goldilocks

Macro: Growth accelerates driven by big fiscal stimulus and an artificial intelligence-induced productivity boom. Trade tensions ease as new trade deals are struck and geopolitical tensions calm. Rising productivity keeps inflation in check despite a tight labour market and fiscal stimulus, allowing central banks to gradually cut interest rates back towards neutral despite still solid growth.

Markets: A very positive environment for stocks globally, particularly in emerging markets. Fixed income also sees strong returns as interest rates move lower and credit spreads tighten to new record levels.

Authors



Karen Ward
Chief Market Strategist EMEA



Tilmann Galler
Global Market Strategist



Maria Paola Toschi
Global Market Strategist



Hugh Gimber
Global Market Strategist



Aaron Hussein
Global Market Strategist



Max McKechnie
Global Market Strategist



Natasha May
Global Market Analyst



Zara Nokes
Global Market Analyst

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